Agenda Date: 2/5/03
Agenda Item: LS-A

STATE OF NEW JERSEY

Board of Public Utilities
Two Gateway Center
Newark, NJ 07102
www.bpu.state.nj.us

DIVISION OF ENERGY

IN THE MATTER OF ATLANTIC CITY ELECTRIC) COMPANY – RATE UNBUNDLING, STRANDED) COST AND RESTRUCTURING FILINGS)	Order Seeking Comments Docket Numbers EO97070455, EO97070456 and EO97070457

(SERVICE LIST ATTACHED)

BY THE BOARD:

As set forth more fully in the Board's Final Order in the above Dockets issued on March, 30, 2001, Atlantic City Electric Company ("ACE," "Atlantic" or "the Company") made a business decision to divest its ownership interests in the bulk of its generating units via an auction process subject to Board approval, after which the Board was to determine the stranded costs associated with these units. Also in accordance with the Final Order, prior to divestiture, the generation from the to-be-divested units was to be devoted to the supply of Basic Generation Service ("BGS") during the transition period approved by the Board for implementing the rate reductions, rate unbundling, retail choice and other provisions of the 1999 Electric Discount and Energy Competition Act; *N.J.S.A*. 48:3-49, *et seq*. ("EDECA"). The revenue received from the Company's Market Transition Charge ("MTC"), as well as that from supplying BGS, was to be applied to the revenue requirement of the to-be-divested units, as follows:

> During the period between August 1, 1999 and the completion of the divestiture of generation assets, MTC revenues shall be applied to owned generation revenue requirements, including continued depreciation of assets, and return on investment, operating and maintenance expenses and fuel expenses, and, between the time of divestiture closing and time of securitization closing, MTC revenues shall be applied to provide a return on the net owned generation costs at 13.0% pre-tax. At time of the termination of the MTC (upon the establishment of the TBC), total MTC revenues and market revenues received from the crediting of owned generation power to BGS in accordance with paragraph 7 (as modified) will be reconciled to the amounts indicated, including a review of the prudence and reasonableness of the Company's operation of the units, and the Deferred

> Balance will be reconciled accordingly to reflect a resulting shortfall or excess. [Final Order at 92, paragraph 22]

If the above sources of revenue were insufficient to recover the revenue requirement of the to-be-divested units, the shortfall, as indicated above, was to be included in Atlantic's deferred balance, on which interest is accrued at the rate on 7-year constant maturity treasuries, as shown in the Federal Reserve Statistical Release on or closest to August 1 of each year, plus 60 basis points, as set forth on page 82 of the Final Order.

In addition, the Final Order set forth how the stranded costs of the divested units were to be determined (in paragraphs 17, 18 and 19 on pages 89 through 91), and how the generation from the to-be-divested generating units was to priced for BGS purposes (at the "floor" shopping credit less transmission cost, the 6% New Jersey Sales and Use Tax, line losses, ancillary services and capacity reserve margin), as set forth in paragraph 7 on page 87.

By letter to the Director of the Board's Energy Division dated May 23, 2002, with a copy to the Division of the Ratepayer Advocate ("Advocate" or "RPA"), the Company advised the Board that, as a result of NRG Energy, Inc. ("NRG") terminating its agreement to purchase the Company's ownership interests in its fossil-fueled B. L. England, Deepwater, Keystone and Conemaugh generating units on April 1, 2002, the Company, through its parent company, Conectiv, was re-offering its interests in these units for sale.[1] The letter went on to note that the Company would soon be mailing out an Early Interest Letter to over sixty potential purchasers, followed by an Offering Memorandum and Request for Qualifications expected to be issued in mid-June. The Company indicated it had retained Credit Suisse First Boston and Commonwealth Energy Advisors, Inc., to manage the sale, which it hoped to complete by the end of the year after receiving indicative and final bids in mid-July and mid-September, respectively. Assuming an acceptable bid was received and a purchase and sale agreement could be executed by late September, Board approval and financial closing were anticipated to occur in early 2003.

Five final bids were received, one for B. L. England, and four for Keystone and Conemaugh. The bids were reviewed with the Board's Staff on November 4, 2002, and with the RPA on November 8, 2002, and were judged by the Company to be too low. While above book value, the bids for Keystone and Conemaugh did not, in the Company's judgment, fully reflect the true market value of these units, a judgment strongly concurred in by Staff. Capacity payments

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[1] As indicated above, the Company made a business decision to divest its ownership interests in B. L. England, Keystone and Conemaugh, as well as its interests in its nuclear units, after which the Board was to determine the Company's stranded costs. By Order issued on January 4, 2000 in Docket Nos. EM99080605 and 606, *I/M/O the Request of Atlantic City Electric Company for the Establishment of Auction Standards for the Sale of Certain Non-Nuclear and Nuclear Generating Units*, respectively, the Board approved the process and procedures to be followed as well as the standards to be met in divesting the units. The sale of the Company's nuclear ownership interests was approved by Board Orders in Docket No.EM99110870, *I/M/O the Petition of Atlantic City Electric Company for Approval of the Sale of its Nuclear Generating Units/Regarding the Sale of Nuclear Assets* issued on July 21, 2000 (sale approval) and September 17, 2001 (preliminary determination of stranded costs). By Order dated February 20, 2002 in Docket No. EM00020106, *I/M/O the Petition of Atlantic City Electric Company Regarding the Sale of Certain Fossil Generation Assets*, the Board approved the sale of the fossil units (including Deepwater) to NRG, the winning bidder, which, however, terminated the Purchase and Sale Agreement on April 1, 2002 in accordance with its terms. As shown in Attachment A, the aggregate capacity of these units is 740 Mw. Deepwater has effectively been deregulated since August 1, 1999, pursuant to paragraph 21 on page 91 of the Final Order.

associated with a 10-year Power Purchase Agreement required by the sole bidder for B. L. England made that bid substantially negative on a net present value basis, and therefore unacceptable to the Company. In addition to a soft market generally, the station's high operating costs and continuing environmental uncertainties, particularly the relatively high NOx and SO2 emissions associated with the coal units' cyclone boilers and the need to obtain and economically burn an environmentally acceptable coal to meet emission standards set by the New Jersey Department of Environmental Protection, were largely responsible for the lack of bidder interest and the low bid (a net payment), as compared to the prices coal capacity would typically fetch. Nonetheless, the Company indicated it would continue to negotiate with the bidders to see if there was any possibility of improving the bids. Those attempts proved unsuccessful, as communicated by the Company to Staff and the Advocate at a follow-up meeting held on December 5, 2002, at which time several possible alternatives to the sale of B. L. England were also identified and discussed.

Accordingly, in a news release issued on January 13, 2003 and in an 8-K filed with the Securities and Exchange Commission on the same date, the Company announced that, although it remained interested in selling the fossil assets on acceptable terms, it had terminated the competitive bidding process for the sale of the fossil assets, citing "current conditions in the electric energy market" as its reason for being unable to reach agreements with a number of interested parties. Pending such a potential re-marketing in the event the energy markets improve, as well as possibly pursuing one or more of the alternative options discussed at the December 5th meeting, the Company indicated to Staff and the RPA that it will soon be filing a petition seeking a determination and related securitization of B. L. England's stranded costs. The petition is expected to be filed by the end of January or early February of this year.

Given the current inability to market B. L. England at an acceptable price, and thus not knowing when, if ever, the station will be divested, and in view of its high operating costs compounded by the environmental uncertainties just noted,[2] leading the Board to question whether continuation of a return as high as 13.0% can be justified, the Board is considering whether the above ratemaking treatment should be prospectively modified pending the Board's decision on the Company's planned securitization petition, and for that purpose is seeking the Company's and the RPA's comments on the following options:

1. Amortization of the Company's B. L. England investment over an appropriate term, and at an appropriate debt rate, mirroring a securitization transaction (the ratemaking treatment previously accorded another problem asset, Jersey Central Power & Light Company's ("JCP&L's") Oyster Creek nuclear unit prior to securitization);[3]

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[2] As indicated in Attachment B, based on data supplied by the Company in its pending deferred balance case, *I/M/O the Petition of Atlantic City Electric Company d/b/a Conectiv Power Delivery for Approval of Amendments to its Tariff to Provide for an Increase in Rates for Electric Service*, Docket No. ER02080510, the all-in cost of B. L. England energy, as determined by the Company, was over 9 cents per kwh in the year ended July 31, 2002, the third year of the transition period.

[3] As set forth in the Board's Final Order in JCP&L's restructuring proceeding, *I/M/O Jersey Central Power and Light Company, d/b/a GPU Energy – Rate Unbundling, Stranded Cost and Restructuring Filings*, Docket Nos. EO97070458, 459 and 460, Order dated March 7, 2002, page 100 and paragraph 27 b. on page 111.

2. Reducing the currently-allowed 13% pre-tax return to provide for the recovery of the Company's embedded debt cost, or embedded debt and preferred costs, with no, or a reduced, allowance for common equity return;

3. Continuing the current ratemaking treatment, but capping it by pricing the B. L. England generation at the energy and capacity component of the BGS auction price[4] (i.e., the dollar amount of B. L. England costs recoverable from ratepayers would be the lesser of the capped amount or the station's revenue requirement as currently calculated by the Company);

4. Such other option as the Board may consider and approve after reviewing the Company's and the RPA's responses to this Order.

Accordingly, within 10 days of the date of this Order, the Company is HEREBY DIRECTED to comment as to whether the ratemaking treatment currently accorded its B. L. England station should be prospectively modified as proposed above, or in the alternative continued as is, or be modified in a manner proposed by the Company. The Division of the Ratepayer Advocate may also submit comments supporting or opposing the Board's proposed options, as well as advancing its own. In view of the clear and substantial ratepayer benefit from the retention of the Company's interests in Keystone and Conemaugh,[5] the Board believes the ratemaking treatment currently accorded these units should continue unchanged.

Finally, to assist the Board in its determination as to whether, and if so how the ratemaking treatment accorded B. L. England should be prospectively changed, the Company is additionally HEREBY DIRECTED to file, by months for the year ended July 31, 2003, including as much actual data as is available at the time the filing in response to this Order is made, the following:

1. The rate base on which the Company's present calculation of B. L. England's revenue requirement is based, broken down into gross plant (with land shown separately), accumulated depreciation, accumulated deferred income taxes, fuel inventories, M&S inventories, cash working capital and consolidated taxes;

2. The plant's remaining tax basis;

3. The plant's operating costs, i.e., fuel, non-fuel operating and maintenance expenses shown separately, current and deferred income taxes, the amortization of the ITC, taxes other than income taxes, book and tax depreciation;

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[4] Currently 4.65 cents per kwh, as shown in the Company's response to RAR-MTC-100 in Docket No. ER02080510.

[5] As shown in Attachment B, as calculated by the Company, the all-in cost of Keystone and Conemaugh energy has averaged 2.05 cents per kwh and 2.40 cents per kwh, respectively, over the three years ended July 31, 2002.

4. The return as calculated by the Company under the current ratemaking treatment and the capital structure and costs on which the return calculation is based.

DATED: 2/5/03

BOARD OF PUBLIC UTILITIES
BY:

(SIGNED)

JEANNE M. FOX
PRESIDENT

(SIGNED)

FREDERICK F. BUTLER
COMMISSIONER

(SIGNED)

CAROL J. MURPHY
COMMISSIONER

(SIGNED)

CONNIE O. HUGHES
COMMISSIONER

(SIGNED)

JACK ALTER
COMMISSIONER

ATTEST:(SIGNED)
KRISTI IZZO
SECRETARY

ATTACHMENT A

ATLANTIC CITY ELECTRIC COMPANY

Fossil-Fueled Generating Units Offered for Sale
Docket No. EM99080605

		Capacity (Mw)	
Station	Units	Total	ACE's Share
Wholly-Owned:			
B. L. England	2 Coal	284	284
	1 Oil	155	155
	4 Diesel	8	8
		447	447
Deepwater	1 Gas	86	86
	1 Coal	80	80
	1 CT	19	19
		185	185
Total Wholly-Owned			632
Jointly Owned:			
Keystone	2 Coal	1,700	42
	4 Diesel	11	0
		1,711	42
Conemaugh	2 Coal	1,700	65
	4 Diesel	11	0
		1,711	66
Total Jointly-Owned			108
Total Offered for Sale			740

Source: May 23, 2002 letter filed with the Board.

ATTACHMENT B

ATLANTIC CITY ELECTRIC COMPANY

Revenue Requirement Comparison *
B. L. England, Keystone and Conemaugh
3 Years Ended July 31, 2002

	Year Ended July 31, 2000			Year Ended July 31, 2001			Year Ended July 31, 2002			3 Yrs. Ended July 31, 2002		
	Gwh	$mill.	c/kwh	Gwh	$mill.	c/kwh	Gwh	$mill.	c/kwh	Gwh	$mill.	c/kwh
Keystone	321	$6.6	2.06	306	$6.2	2.02	303	$6.2	2.06	930	$19.0	2.05
Conemaugh	467	$11.4	2.45	480	$11.5	2.39	486	$11.5	2.37	1,433	$34.4	2.40
B. L. England	1,561	$99.8	6.39	1,563	$106.5	6.82	1,144	$107.5	9.40	4,268	$313.8	7.35

*as calculated by the Company, and included in MTC-recoverable costs (net of the revenue received from supplying BGS; response to S-CMTC-7, Docket No. ER02080510).

SERVICE LIST
ATLANTIC CITY ELECTRIC COMPANY
Request for the Establishment of Auction Standards
For the Sale of Certain Non-Nuclear Generating Units
Docket No. EM99080605

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